Editor's note: The citation in the last paragraph on p. 51 is incorrect, it should read Creme Manufacturing Co., Inc. v. United States, 492 F.2d 515, 521 (5th Cir. 1974).

GETTY OIL CO.

IBLA 80-430 Decided October 31, 1980

Appeal from a decision of the Director, Geological Survey, affirming an order of the Acting Oil and Gas Supervisor, Accounting, Gulf of Mexico Area, requiring payment of additional royalties for gas produced on lease OCS G-1752.

Reversed.

1. Oil and Gas Leases: Royalties -- Outer Continental Shelf Lands Act: Oil and Gas Leases

   A Geological Survey decision requiring additional royalties to be paid under oil and gas lease OCS G-1752 will be reversed where such decision rests upon the assumption that a parent corporation can rescind at will a contract for the sale of natural gas entered into with its wholly owned subsidiary, especially where all of the evidence indicates that the agreement does, in fact, represent fair market value and where other Governmental regulatory controls are applicable and the rights of a third party will be affected.

APPEARANCES: George J. Domas, Esq., Liskow & Lewis, New Orleans, Louisiana, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Getty Oil Company (Getty) appeals from a decision of the Director, Geological Survey (GS), dated January 18, 1980, affirming an order of the Acting Oil and Gas Supervisor, Accounting, Gulf of Mexico Area, requiring Getty to pay additional royalties for gas produced by Getty during the period June 15, 1972, through December 31, 1977. The lease in question, OCS G-1752, is located in Block A-76, Brazos Area, South Addition, offshore Matagorda County, Texas. Appellant is the owner of an undivided 50 percent interest in the subject lease granted in 1968.

Oral argument was held before the Board on September 16, 1980, at which counsel for Getty participated. Although both the Office of the Solicitor and the Geological Survey were notified of the oral argument by the Board's order, no representative for Geological Survey was present.

By agreement dated August 7, 1970, appellant entered into a gas purchase contract with Transcontinental Gas Pipe Line Corporation (Transco) by which Getty agreed to sell to Transco a part of its production from lease OCS-G 1752 (the gas purchase contract). This gas purchase contract specifically reserved to appellant that portion of its production covered by a transportation agreement which was amended by a letter agreement between Transco and appellant dated May 20, 1971.

The transportation agreement, as amended (the transportation agreement), provides for the transportation by Transco of a portion of appellant's natural gas from the lease, up to 9,300 Mcf of gas per day, to a connection near a refinery at Delaware City, Delaware, then owned by appellant.

Counsel for appellant maintains that prior to any production from the lease, the ownership of all of the assets (along with attendant obligations) of appellant's Eastern Marketing and Manufacturing Division, including the Delaware City refinery, was transferred by appellant to its wholly owned subsidiary, Getty Oil Company, Eastern Operations, Inc. (Eastern Operations), a Delaware corporation. A letter agreement, executed on February 26, 1973, by appellant and Eastern Operations, recites the transfer of all of appellant's rights, privileges, and interests in the transportation agreement, as well as its obligations, liabilities, and commitments thereunder. This letter agreement also recites an agreement by which Getty will sell to Eastern Operations all the gas delivered to Transco under the transportation agreement. For such gas, Eastern Operations will pay the same price per Mcf which Getty receives from Transco under its gas purchase contract. The effective date of this letter agreement, as stated therein, is March 31, 1972.

An audit of the royalties paid by Getty on lease OCS G-1752 determined that additional royalties in the amount of $ 484,329.47 were due for the period June 15, 1972, through December 31, 1977. The first production on the subject lease had occurred on June 17, 1972. An order of the Acting Oil and Gas Supervisor, Accounting, Gulf of Mexico Area, was accordingly issued on November 29, 1978, requiring payment of this sum. Getty did not dispute that $ 24,677.19 was properly owing, but appealed the Supervisor's order to the Director insofar as it required payment of $ 459,652.28 in back royalties.

By decision of January 18, 1980, the Director affirmed the Supervisor's order of November 29, 1978. Key to both the Supervisor's order and the Director's decision is the following passage from the auditor's report:

> Since Getty always had the option of selling the, residue gas on the interstate market, we believe the correct value of the residue gas is the highest price Getty could have obtained on the interstate market if each month's production had been offered as a separate or new sale. The method used by Getty did not meet this criterion. Instead, Getty's approach was to use the FPC price schedules for a long-term fixed contractual commitment for the sale of gas. As discussed previously, there were no such contractual commitments.
>
> The FERC furnished us with information reflecting the highest allowable interstate prices assuming each month's production had been offered as a new sale. * * * We then recomputed all royalty calculations applying the prices furnished by the FERC after adjustment for BTU content. The difference in valuation methods on gas transported to Getty's refinery results in additional royalties due in the amount of $ 459,652.28. [Footnote omitted.]

(Director's decision, pp. 6-7). Appellant suggests that the above passage was written by auditors who were unaware of Getty's agreement to sell its residue gas from OCS G-1752 to Eastern Operations. While this may be the case, the Director was fully aware of appellant's contention that Getty's agreement with Eastern Operations precluded it from selling the residue gas on the interstate market. The Director nevertheless held:

> Since the subsidiary to which Getty sold the gas is wholly controlled by Getty, there was nothing preventing Getty from rescinding the contract for the sale of the gas and reselling it at higher prices. Accordingly the Area Supervisor could properly require that the gas be valued as if Getty had sold it at such maximum allowable prices.

Essential to Getty's appeal is the validity of its agreement for the sale of gas to Eastern Operations.

Appellant asserts that its agreement with Eastern Operations to purchase gas from lease OCS G-1752 was a valid contract effective March 31, 1972. It maintains that the letter agreement of February 26, 1973, was executed merely as a housekeeping measure to formalize the agreement and intent of the parties to transfer the assets and obligations of the Eastern Marketing and Manufacturing Division to Eastern

Operations. 1/ In support of these assertions, appellant argues that its agreement with Eastern Operations is not rendered invalid by the mere fact that the parties thereto are a parent corporation and its wholly owned subsidiary.

[1] We agree with appellant that a parent corporation and its wholly owned subsidiary may enter into a valid contract. In United States v. Weissman, 219 F.2d 837 (2nd Cir. 1955), Judge Learned Hand wrote: "It is true that there can be legal transactions between two corporations all of whose shares are owned by a single individual, and that the same obligations will arise out of them as would arise, had they been between either corporation and a third person." It is the general rule that courts will not, because of stock ownership or interlocking directorates, disregard the separate legal identities of corporations, unless such relationship is used to defeat public convenience, justify wrongs (e.g., violation of antitrust laws), protect fraud, or defend crime. Norton v. Integral Corp., 584 S.W.2d 932, 935 (1979).

No facts appear in the record to indicate that Getty's transfer of its assets and obligations to Eastern Operations was for other than a legitimate business purpose. According to counsel, Getty's purpose was to segregate its manufacturing and marketing of refined products from the exploration and production operations to permit more effective administration and control of costs. 2/

GS's statement that Getty could rescind its contract with Eastern Operations and sell the residue gas at higher prices is thus far contrary to the actual course of events. Neither party to this agreement, counsel informs us, has sold the residue gas to a third party. The gas sold to Eastern Operations is used at its Delaware City refinery to produce hydrogen employed in the hydrocracking and hydrodesulphurization of high sulphur content crude oils.

Furthermore, both Transco and Eastern Operations have obtained certificates of public convenience and necessity from the Federal Power

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1/ The minutes of the meeting of the Board of Directors, Getty Oil Company, reveal that on March 3, 1972, the Board unanimously adopted resolutions approving the reorganization of Getty's Eastern Marketing and Manufacturing Division. The transfer of certain assets and liabilities to Eastern Operations was the focus of the reorganization plan. This transfer is embodied in a "General Indenture of Conveyance, Assignment, Transfer and Sale" with an effective date of March 30, 1972.

2/ Parties to a contract are free to establish an effective date of a contract prior to the date of execution of a formal written contract. Brewer v. National Surety Corp., 169 F.2d 926, 928 (10th Cir. 1948).

Commission (FPC), now the Federal Energy Regulatory Commission (FERC). For Getty to be able to sell the residue gas to a third party, both Transco and Eastern Operations would have to obtain abandonment authority from FERC pursuant to section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b) (1976). There would seem to be no guarantee that Transco, who is transporting the residue gas for a fee and presumably earning a profit, would consent to seek an abandonment, even if FERC were inclined to grant such.

We believe it was error, in the absence of even a suggestion of impropriety, for GS to disregard the validity of Getty's agreement with Eastern Operations. Its assessment of additional royalties for the period June 15, 1972, through December 31, 1977, is not supported by the law or the facts.

As set forth above, Getty sold its residue gas to Eastern Operations for the same price which Transco paid to Getty under the gas purchase contract of August 7, 1970. The Department's audit of this contract price found, with minor exception, that Getty had correctly valued this gas for sale to Transco. The price to Transco was determined in accordance with FPC (now FERC) Opinions 595 and 749. While maintaining that Getty's sale to Eastern Operations was not subject to FERC opinions, counsel for Getty points out that Getty received from Eastern Operations the highest price obtainable in the interstate market at the time its contract was entered on March 31, 1972.

Although contracts between a parent corporation and its subsidiary may not be at arm's length, they may result in a fair market price. If a transaction is not at arm's length, some other manifestation that the price is nonetheless an accurate portrayal of the article's worth is required. It must be a price which independent buyers in arm's length transactions would be willing to pay. Acme Manufacturing Co., Inc. v. United States, 492 F.2d 515, 520 (5th Cir. 1974). Inasmuch as the auditors clearly found that the price obtained by Getty pursuant to the gas purchase contract represented fair market value, and recognizing that royalty was tendered for the gas involved in the transportation agreement at the same rate, it seems clear to us that the price provided in the transportation agreement was the fair market price.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director is reversed, and the case remanded to GS for appropriate action consistent with this opinion.

Douglas E. Henriques
Administrative Judge

We concur:

Joan B. Thompson
Administrative Judge

James L. Burski
Administrative Judge